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UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
3:05-CV-345-MU

FILED

AUG 29 2005

Clerks Office
N.C. Utilities Commission

BELLSOUTH)
TELECOMMUNICATIONS, INC.,)

Plaintiff,)

v.)

NORTH CAROLINA UTILITIES)
COMMISSION; JO ANNE SANFORD,)
Chairman; ROBERT K. KOGER,)
Commissioner; ROBERT V. OWENS,)
JR., Commissioner; SAM J. ERVIN, IV,)
Commissioner; LORINZO L. JOYNER;)
Commissioner; JAMES Y. KERR, II,)
Commissioner; and HOWARD N. LEE,)
Commissioner (in their official capacities)
as Commissioners of the North Carolina)
Utilities Commission),)

Defendants.)

ORDER

P-100, sub 12b

No dist.
per DB

THIS MATTER is before the Court on Plaintiff BellSouth Telecommunications, Inc.'s ("BellSouth") Motion for Temporary Restraining Order and Preliminary Injunction, [file doc. 10], and Memorandum in Support, both filed August 2, 2005. Also on August 2, 2005, this Court entered an Order granting BellSouth's Motion for a Temporary Restraining Order and setting a hearing for this matter which was held on August 11, 2005 at 2:00 p.m. While the North Carolina Utilities Commission (the "Commission") and the Commissioners (collectively referred to as "Defendants") named above did not file a written Response to the Motion for Preliminary Injunction, defense counsel for both did attend the hearing, although only in her

capacity as counsel to the Commissioners.¹ Having heard and considered the arguments of BellSouth and the Commissioners, this matter is ripe for ruling by the Court. For the reasons stated below, the Court hereby GRANTS BellSouth's Motion for Preliminary Injunction.

I. FACTUAL AND PROCEDURAL HISTORY

This case is centered around the interpretation of several provisions of the Telecommunications Act of 1996 (the "Act"). In the spirit of fostering competition, the Act imposes several requirements on incumbent local exchange carriers ("ILECs"), like BellSouth, to make their retail telecommunications services available to competing local providers ("CLPs") at discounted wholesale rates. See 47 U.S.C. § 251(c)(4)(A). Pursuant to 47 U.S.C. § 252(d)(3), State commissions determine the wholesale rates on the basis of the ILEC's retail rates, excluding any portion attributable to marketing, among other things. In practical terms, it is both the Commission and the market which set the wholesale rates available to CLPs. ILECs propose a wholesale rate bearing in mind what the market will tolerate, but before they can sell these telecommunications services, the Commission must approve the rates.

As explained above, many factors influence the value of the wholesale rates. And, as would be expected, the Federal Communications Commission ("FCC") has weighed in on the issue of what should be considered when valuing wholesale rates. Specifically, and of importance to the outcome of this matter, the FCC has found that promotional offerings that are in effect for more than ninety days essentially become the retail rate from which the wholesale rate is determined. *In the Matter of Implementation of the Local Competition Provisions in the*

¹ Defense counsel stated on the record that she was only appearing in her capacity as counsel to the Commissioners because the North Carolina Utilities Commission seeks to have this action dismissed against it without making an appearance in the matter.

Telecommunications Act of 1996, (CC Docket 96-58); First Report and Order, FCC No. 96-325, 11 FCC Rcd 15499 (rel. August 8, 1996), ¶ 948. This point is further clarified through the negative implication of 47 C.F.R. § 51.613(2)(D), which states that "promotions" lasting less than ninety days are not considered when determining the wholesale rate.

The dispute between BellSouth and the Defendants arose when the Defendants issued a December 22, 2004 Order Ruling on Motion Regarding Promotions and a June 3, 2005 Order Clarifying Ruling on Promotions and Denying Motions for Reconsideration and Stay (collectively the "Resale Orders"). The Resale Orders found that incentives, such as gift cards, that are in effect for more than ninety days "are in fact promotional offers subject to the FCC's rules on promotions." On the other hand, BellSouth argued in oral argument that gift cards and other such giveaways are not telecommunications services, and as such are not regulated by the Act.

More specifically, BellSouth cites to the FCC's definition of "promotions" to make the argument that items such as gift cards are in fact *marketing* incentives, which are specifically excluded from the valuation of wholesale rates by 47 U.S.C. § 252(d)(3). (Pl.'s Mem. at 11.) The FCC has defined "promotions" to include "price discounts from standard offerings that will remain available for resale at wholesale rates, i.e., temporary price discounts." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996* (CC Docket No. 96-58); First Report and Order, FCC No. 96-325, 11 FCC RCD 15499, (rel. Aug. 8, 1996), ¶ 948.

Pursuant to 47 U.S.C. § 252(e)(6), BellSouth has brought the matter to this Court to determine whether the Resale Orders are in fact contrary to the statutory provisions of the Act.

At this stage in the proceedings, BellSouth seeks a Preliminary Injunction prohibiting the Defendants from enforcing those provisions of the Resale Orders which would require ILECs to take into consideration the value of gift cards and other giveaways in the same manner that rate discounts which last for longer than ninety days are considered when arriving at the wholesale rate for telecommunications services for CLPs.

II. DISCUSSION

The "balance of hardships" test is used to determine the propriety of preliminary injunctive relief. *Blackwelder Furniture Co. v. Seilig Mfg. Co.*, 550 F.2d 189, 196 (4th Cir. 1977). This test weighs the following four factors: (1) the likelihood of irreparable harm to the plaintiff if the preliminary injunction is denied; (2) the likelihood of harm to the defendants if the requested relief is granted; (3) the likelihood that plaintiff will succeed on the merits; and (4) the public interest. *Id.* Further, the plaintiff bears the burden of establishing that each of the four elements supports granting the injunction. *Dirx Israel, Ltd. v. Breakthrough Medical Corp.*, 952 F.2d 802, 812 (4th Cir. 1992).

A. Irreparable Harm to BellSouth in the Absence of a Preliminary Injunction

The question of irreparable harm to the plaintiff is the first factor to be considered in a motion for preliminary injunction. *Id.* If a plaintiff cannot establish that irreparable harm is likely to occur in the absence of a preliminary injunction, that failure alone is sufficient to deny injunctive relief. *Manning v. Hunt*, 119 F.3d 254, 266 (4th Cir. 1997). "Moreover, the required 'irreparable harm' must be 'neither remote nor speculative, but actual and imminent.'" *Dirx*, 952 F.2d at 812 (quoting *Tucker Anthony Realty Corp. v. Schlesinger*, 888 F.2d 969, 975 (2d Cir. 1989)). However, as the balance tips in favor of finding irreparable harm to plaintiff, there is a

lesser need for plaintiff to establish likelihood of success on the merits. *Rum Creek Coal Sales, Inc. v. Caperton*, 926 F.2d 353, 359 (4th Cir. 1991).

In the instant case, BellSouth has established that it will suffer actual, imminent, and irreparable harm if the Court does not enter the requested preliminary injunction. BellSouth represented to the Court that implementation of the Resale Orders would require them to create significant changes in their marketing structure. The marketing efforts in North Carolina would be carried out in a substantially different manner than efforts in other states where BellSouth does business. Putting aside the large financial burden of this effort, the lasting impact that this two-tiered marketing could have on customer loyalty and BellSouth's goodwill in North Carolina cannot be understated. A North Carolina customer visiting Georgia would understandably become rather disgruntled to learn that the same benefits were not offered to him as were offered to BellSouth customers in Georgia.

Further, there would be the same loss of customer loyalty when North Carolina residents learn that many of the CLPs are able to offer much better incentives than BellSouth. Customer loyalty is not the type of loss that can be made whole with a court order at the end of a lawsuit. Additionally, there is the direct financial loss which will occur if the wholesale rates are suddenly decreased to comply with the Resale Orders. The beneficiaries of this decrease, the CLPs, are not even a party to this action.

In sum, if the Court does not enter a preliminary injunction, Defendants' ruling will result in irreparable harm to BellSouth.

R. Likelihood of Harm to Defendants if Preliminary Injunction is Granted

The Court finds that if the Resale Orders are implemented, the harm to BellSouth

certainly outweighs any harm to Defendants. In fact, the Defendants were unable to name any harm that they would incur as a result of a Preliminary Injunction. Defendants pointed out that the fourth factor, the public interest, should be considered in this step as well due to the fact that Defendants represent the public interest. However, there is no clear argument that the public interest would not be best served by granting this Preliminary Injunction. The Court has not been convinced that the Resale Orders will actually promote competition. At this point in the proceedings, there appears to be a valid argument that the Resale Orders are actually going to hinder competition in North Carolina. It is precisely the intent of the Act to foster competition for the public good.

Therefore, the likelihood of harm to BellSouth if the injunction is not granted significantly outweighs any possible harm to Defendants resulting from the imposition of the injunction.

C. BellSouth's Likelihood of Success on the Merits of its Claims

Since the Court finds that BellSouth would suffer irreparable harm in the absence of a preliminary injunction, the Court will not discuss in detail whether BellSouth has a likelihood of success on the merits of its claims. The Court notes, however, that BellSouth has sufficiently convinced the Court that this novel issue of law merits further review.

D. Public Interest

As discussed above, the Court further finds that the public interest is served by the issuance of the requested injunction. The impact of the Resale Orders would result in North Carolina residents being treated differently than similarly situated residents of other states through the interpretation of a federal law.

In conclusion, the Court finds that the entry of a preliminary injunction is necessary to protect BellSouth from actual, imminent and irreparable harm. Such harm to BellSouth significantly outweighs any harm that Defendants may incur as a result of the entry of the injunction.

E. Rule 65(c) of the Federal Rules of Civil Procedure

The Federal Rules of Civil Procedure state that "[n]o . . . preliminary injunction shall issue except upon the giving of security by the applicant, in such sum the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained." Fed. R. Civ. P. 65(c). As noted in Rule 65, the amount of bond is within the discretion of the Court. *Maryland Dept. of Human Resources v. U.S. Dept. of Agriculture*, 576 F.2d 1462, 1483 (4th Cir. 1992). The Court here finds that a bond of \$100 is sufficient to cover Defendant's costs or damages should it later be determined that Defendant was wrongfully enjoined.

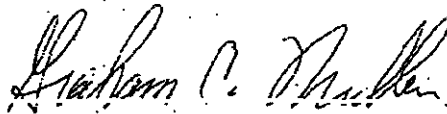
IT IS THEREFORE ORDERED that Plaintiff's Motion for Preliminary Injunction is hereby **GRANTED**. Pending a trial on the merits, Defendants are enjoined and restrained from enforcing Conclusion No. 5 of the Commission's December 22, 2004 Order Ruling on Motion Regarding Promotions, *In the Matter of Implementation of Session Law 2003-51, Senate Bill 814 Titled "An Act to Clarify the Law Regarding Competitive and Deregulated Offerings of Telecommunications Services,"* Docket No. P-100, Sub-72b as well as the Commission's Conclusions regarding Resale Obligations and One-Time Gift Promotions in its June 3, 2005 Order Clarifying Ruling on Promotions and Denying Motions for Reconsideration and Stay, *In the Matter of Implementation of Session Law 2003-51, Senate Bill 814 Titled "An Act to Clarify*

The Law Regarding Competitive and Deregulated Offerings of Telecommunications Services,"

Docket No. P-100, Sub-72b (pp. 5-7, therein).

IT IS FURTHER ORDERED that BellSouth shall post a bond of \$100.00.

Signed: August 12, 2005

A handwritten signature in cursive script, appearing to read "Graham C. Mullen".

Graham C. Mullen
Chief United States District Judge



EXHIBIT G

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
3:05CV345-MU

BELLSOUTH TELECOMMUNICATIONS,
INC.,

Plaintiff,

vs.

JO ANNE SANFORD, Chairman; ROBERT K.
KOGER, Commissioner; ROBERT V. OWENS,
JR., Commissioner; SAM J. ERVIN, IV,
Commissioner; LORINZO L. JOYNER,
Commissioner; JAMES Y. KERR, II,
Commissioner; and HOWARD N. LEE,
Commissioner (in their official capacities as
Commissioners of the North Carolina Utilities
Commission),

Defendants.

ORDER

This matter is before the court upon cross-motions for summary judgment filed by Plaintiff BellSouth Telecommunications, Inc. ("BellSouth") and the Defendant Commissioners of the North Carolina Utilities Commission (the "Commissioners"). It appears to the court that there are no genuine issues of material fact, and this matter is now ripe for disposition.

BACKGROUND

BellSouth is an incumbent local exchange carrier ("ILEC"). Under the Telecommunications Act of 1996 (the "Act"), BellSouth, as an ILEC, is required to offer its telecommunications services to competing local providers ("CLPs") for resale at wholesale rates established by the North Carolina Utilities Commission (the "NCUC"). Specifically, the Act

requires ILECs to "offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." 47 U.S.C. § 251(c)(4). Wholesale rates are determined by State commissions "on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."¹ 47 U.S.C. § 252(d)(3).

The Federal Communications Commission ("FCC") has determined that the Act's resale obligations extend to promotional price discounts offered on retail communications services. However, the FCC has expressly limited the scope of the term "promotions" to "price discounts from standard offerings that will remain available for resale at wholesale rates, i.e., temporary price discounts." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, (CC Docket No. 96-98); First Report and Order, FCC No. 96-325, 11 FCC Rcd 15499, (rel. Aug. 8, 1996), ¶ 948 ("First Report and Order"). The FCC further concluded that "short term promotional prices," which are defined as "promotions of up to 90 days," "do not constitute retail rates for the underlying services and are not subject to the wholesale rate obligation." *Id.* at ¶¶ 949 & 950. Thus, promotional prices offered for a period of 90 days or less need not be offered to resellers at a wholesale discount, whereas promotional prices offered for periods greater than 90 days must be offered for resale at the wholesale rate.

BellSouth uses certain marketing incentives in all nine states in which it operates. These incentives include gift cards or other one-time giveaways that encourage customers to subscribe

¹The NCUC has established that CLPs may purchase BellSouth's retail telecommunications services in North Carolina at a 21.5% wholesale discount less the retail price for business services and for 17.6% less than the retail price for residential services.

to BellSouth's telecommunications services. CLPs that compete with BellSouth regularly employ similar marketing practices. These marketing incentives are redeemable only for unaffiliated, that is, non-BellSouth, goods or services. Because these types of marketing incentives originate from unaffiliated companies, BellSouth is unable to track their usage or redemption rates.

In June of 2004, the Public Staff of the NCUC filed a Motion for Order Concerning Eligibility for One-Day Notice and ILECs' Obligations to Offer Promotions to Resellers. One of the issues on which the Public Staff sought guidance was the following: "If a [local exchange carrier] offers a benefit in the form of a check, a coupon for a check, or anything else of value for more than ninety days to incent subscription or continued subscription to a regulated service, is it required that the benefit be offered to resellers in addition to the reseller discount?" The Public Staff took the position that marketing incentives such as gift cards, checks, etc. "effectively" constitutes a discount on telecommunications services and are subject to resale obligations. On December 22, 2004, the NCUC issued its Order Ruling on Motion Regarding Promotions (the "First Resale Order"), holding that marketing incentives "are in fact promotional offers subject to the FCC's rules on promotion," and that "in order for a gift card type promotion not to require an adjustment to the resale wholesale rate (caused by the fact that the retail price has in effect been lowered), such a promotion must be limited to 90 days." While acknowledging that marketing incentives "are not discount service offerings *per se* because they do not result in a reduction of the tariffed retail price charged for the regulated service at the heart of the offerings," the NCUC nevertheless concluded that a marketing incentive "reduces the subscriber's cost for the service by the value received in the form of a gift card or other

giveaway.” First Resale Order, p. 11. Thus, the NCUC stated, “The tariffed retail rate would, in essence, no longer exist, as the tariffed price minus the value of the gift card received for subscribing to the regulated service, i.e., the promotional rate, would become the ‘real’ retail rate.” Id.

On February 18, 2005, BellSouth filed a Motion for Reconsideration or, in the Alternative, for Clarification, and for a Stay of the Commission’s December 22, 2004 Order. On June 3, 2005, the NCUC issued its Order Clarifying Ruling on Promotions and Denying Motions for Reconsideration and Stay (the “Second Resale Order”). In this Order, the NCUC held that marketing incentives have the effect of lowering “the actual, ‘real’ retail rate.” Second Resale Order, p. 5. The NCUC further required BellSouth to determine “the price lowering impact of any such 90 day plus promotions on the real tariff or retail list price” and pass the benefit of such a reduction on to resellers through a wholesale discount on the “lower actual retail price.” Id. at p. 6.

BellSouth filed this action on August 2, 2005 seeking declaratory and injunctive relief with respect to the two Orders of the NCUC, alleging that the Orders violate the Act. BellSouth also filed a Motion for Preliminary Injunction seeking to enjoin enforcement of those provisions of the Orders requiring ILECs to take into consideration the value of gift cards and other giveaways in the same manner that rate discounts which last longer than ninety days are considered when arriving at the wholesale rate for telecommunications services for CLPs. After a hearing on August 11, 2005, this court granted BellSouth’s Motion for Preliminary Injunction. The parties have now filed their cross-motions for summary judgment.

DISCUSSION

BellSouth alleges that the NCUC's conclusions that BellSouth is required to offer CLPs a wholesale discount on marketing incentives (or the value thereof) in addition to the wholesale discount offered on its retail telecommunications services is in violation of the Telecommunications Act. The court reviews the NCUC's interpretations of the Act *de novo*. GTE South, Inc. v. Morrison, 199 F.3d 733, 745 (4th Cir. 1999). However, "[a] 'state agency's interpretation of federal statutes is not entitled to the deference afforded a federal agency's interpretation of its own statutes . . .'" *Id.* (quoting Orthopaedic Hosp. v. Belshe, 103 F.3d 1491, 1495-96 (9th Cir. 1997)). The court has carefully reviewed the two Orders of the NCUC, the arguments of counsel, and the pertinent law, and concludes that the Orders of the NCUC are contrary to and in violation of the Act.

The first rule of statutory construction is that a court must look to the language of the statute. When examining the language of a statute, the court "must presume that a legislature says in a statute what it means and means in a statute what it says there." Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253-54 (1992). The court may look beyond the express language of the statute only when the language of the statute is ambiguous or where a literal interpretation would thwart the purpose of the overall statutory scheme. U.S. v. Tex-Tow, Inc., 589 F.2d 1310, 1313 (7th Cir. 1978).

Looking to the language of the Act, Congress' intent is plain. Section 251 (c)(4) requires an ILEC to offer for resale "any telecommunications service" it provides at retail to subscribers who are not telecommunications carriers. There can be no argument that gift cards, checks, coupons for checks, and similar types of marketing incentives are "telecommunications services." Indeed, in its First Resale Order, the NCUC conceded that marketing incentives "are

not discount service offerings *per se* because they do not result in a reduction of the tariffed retail price charged for the regulated service . . .” First Resale Order, p. 11.

As noted above, the FCC has determined that the Act’s resale obligations extend to *promotional price discounts* offered on retail communications services. In its First Report and Order, the FCC stated in unambiguous terms that “promotions” refers only to “*price discounts* from standard offerings that will remain available for resale at wholesale rates, i.e., temporary price discounts.” First Report and Order, ¶ 948. Had the FCC wished to include marketing incentives such as Walmart gift cards in the definition of “promotions,” it could have easily done so. The marketing incentives at issue here do not give the customer a reduction or discount on the price of the telecommunications service provided by BellSouth. A customer receiving a Walmart gift card in exchange for signing up to receive certain services, for example, will pay the same full tariff price for the service each month as customers who subscribed to the service without the benefit of the gift card. Moreover, a customer cannot use a Walmart gift card or coupon to pay her phone bill. If the marketing incentive came in the form of a bill credit or other direct reduction in the price paid for a particular service, then the incentive would certainly be considered a promotional discount that would trigger BellSouth’s resale obligations.

The NCUC’s Orders purport to extend the definition of promotional discounts to include anything of economic value. The court believes that this interpretation is contrary to the plain language of the statute and the FCC implementing regulations. Accordingly,

IT IS THEREFORE ORDERED that BellSouth's Motion for Summary Judgment is hereby GRANTED, and the Commissioners' Motion for Summary Judgment is hereby DENIED.

Signed: May 15, 2006

A handwritten signature in cursive script, appearing to read "Graham C. Mullen", written over a horizontal line.

Graham C. Mullen
United States District Judge



EXHIBIT H

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
CASE NO.: _____

BELLSOUTH TELECOMMUNICATIONS,
INC.,

Plaintiff,

vs.

IMAGE ACCESS, INC. d/b/a NEWPHONE,

Defendant.

COMPLAINT

BellSouth Telecommunications, Inc. ("BellSouth"), complaining of the Defendant, Image Access, Inc. d/b/a NewPhone ("Image Access"), alleges and says that:

PARTIES, JURISDICTION, AND VENUE

1. BellSouth is a Georgia corporation with its principal place of business in Atlanta, Georgia. BellSouth is an Incumbent Local Exchange Carrier ("ILEC") under the Communications Act of 1934, as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (the "Act").

2. Image Access is a Louisiana corporation with its principal place of business in Metairie, Louisiana. Image Access is a Competitive Local Exchange Carrier under the Act, also known as a Competing Local Provider ("CLP").

3. This Court has subject matter jurisdiction of this action pursuant to 28 U.S.C. § 1332 in that BellSouth and Image Access are citizens of different states, and the amount in controversy exceeds \$75,000.00, exclusive of interest and costs.

4. Venue is proper in this district under 28 U.S.C. § 1391(a).

**BELLSOUTH'S RESALE OBLIGATIONS UNDER THE ACT AND
THE BELLSOUTH-IMAGE ACCESS INTERCONNECTION AGREEMENTS**

5. To foster CLPs' ability to compete with ILECs in the telecommunications marketplace, the Act imposes specific requirements on BellSouth to make its retail telecommunications services available to CLPs such as Image Access at significantly discounted wholesale rates. Image Access, in turn, can then resell those telecommunications services to its customers. Specifically, section 251(c)(4)(A) of the Act requires BellSouth "to offer for resale at wholesale rates any telecommunications service that [it] provides at retail to subscribers who are not telecommunications carriers."

6. Rather than attempting to impose a uniform set of terms for all ILEC/CLP arrangements, the Act obligates ILECs and CLPs to negotiate Interconnection Agreements to implement the specific details of the parties' relationship.

7. On or about June 19, 2002, the BellSouth and Image Access entered into an Interconnection Agreement (hereinafter, the "2002 ICA") in which BellSouth agreed, among other things, to offer various telecommunications services for resale to Image Access at specified wholesale rates and subject to specified exclusions and limitations. 2002 ICA, Attachment 1, section 3.1. The 2002 ICA covered the resale of telecommunications services to Image Access in all nine states in which BellSouth operates as an ILEC. A copy of the pertinent provisions of the 2002 ICA is attached hereto as Exhibit A.

8. In consideration for BellSouth's agreement to make its retail telecommunications services available for resale, Image Access agreed to make payment to BellSouth for all services billed, in immediately available funds, and that said payments would be due by the next bill date (i.e., the same date in the following month as the bill date). 2002 ICA, Attachment 1, sections 7.2 & 7.5.

9. Image Access further agreed that if any portion of its payment is received by BellSouth after the due date or in funds that are not immediately available to BellSouth, then a late payment penalty shall be due to BellSouth. 2002 ICA, Attachment 1, section 7.9.

10. The 2002 ICA contained no provision allowing Image Access to withhold any amounts due to BellSouth based on the value of any cash back promotions or other marketing incentives that BellSouth employed as part of its marketing strategy.

11. BellSouth and Image Access amended the 2002 ICA in November 2003, July 2004, and November 2004, but the provisions addressing BellSouth's resale obligations and Image Access' corresponding payment obligations remained unchanged.

12. In March, 2006, BellSouth and Image Access entered into a second Interconnection Agreement (hereinafter, the "2006 ICA"; the 2002 ICA and 2006 ICA shall be referred to collectively as the "ICAs"). A copy of the pertinent provisions of the 2006 ICA is attached hereto as Exhibit B. The 2006 ICA similarly provides that BellSouth agrees to offer various telecommunications services for resale to Image Access at specified wholesale rates and subject to specified exclusions and limitations. 2006 ICA, Attachment 1, section 4. The 2006 ICA covers the resale of telecommunications services to Image Access in all nine states in which BellSouth operates as an ILEC.

13. In consideration for BellSouth's agreement to make its retail telecommunications services available for resale, Image Access agreed to make payment to BellSouth for all services billed, in immediately available funds, and that said payments would be due by the next bill date (i.e., the same date in the following month as the bill date). 2006 ICA, Attachment 7, sections 1.4 & 1.4.1.

14. Image Access further agreed that if any portion of its payment is received by BellSouth after the due date or in funds that are not immediately available to BellSouth, then a late payment penalty shall be due to BellSouth. 2006 ICA, Attachment 7, section 1.4.3.

15. The 2006 ICA contained no provision allowing Image Access to withhold any amounts due to BellSouth based on the value of any cash back promotions or other marketing incentives that BellSouth employed as part of its marketing strategy.

RELATED LITIGATION CONCERNING BELL SOUTH'S RESALE OBLIGATIONS

16. The Federal Communications Commission ("FCC") has concluded that ILECs' statutory resale obligation includes promotional price discounts offered on retail telecommunications services. The FCC has defined "promotions" to include "price discounts from standard offerings that will remain available for resale at wholesale rates, i.e., temporary price discounts." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996* (CC Docket No. 96-98); First Report and Order, FCC No. 96-325, 11 FCC Rcd 15499, (rel. Aug. 8, 1996) ("First Report and Order"), para. 948.

17. The FCC has also concluded that "short-term promotional prices," which are defined as "promotions of up to 90 days," "do not constitute retail rates for the underlying services and are thus not subject to the wholesale rate obligation." First Report and Order, paras. 949 & 950. Thus, promotional prices offered for a period of 90 days or less need not be offered to resellers at a wholesale discount, whereas promotional prices offered for periods greater than 90 days must be offered for resale at the wholesale discount.

18. Section 252(d)(3) of the Act directs state commissions to "determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing . . . and other costs that will be avoided by the local exchange carrier."

19. On June 25, 2004, the Public Staff of the North Carolina Utilities Commission ("Public Staff") filed a Motion for Order Concerning Eligibility for One-Day Notice and ILECs' Obligations to Offer Promotions to Resellers. Among the issues for which the Public Staff sought guidance was the following: "If a [local exchange carrier] offers a benefit in the form of a check, a coupon for a check, or anything else of value for more than ninety days to incent subscription or continued subscription to a regulated service, is it required that the benefit be offered to resellers in addition to the reseller discount?"

20. After receiving multiple rounds of comments from ILECs and CLPs alike, on December 22, 2004, the Commission issued its Order Ruling on Motion Regarding Promotions (the "First Resale Order"). A copy of the First Resale Order is attached hereto as Exhibit C. The Commission erroneously ruled that marketing incentives "are in fact promotional offers subject to the FCC's rules on promotions" and held that "in order for a gift card type promotion not to require an adjustment to the resale wholesale rate (caused by the fact that the retail price has in effect been lowered), such a promotion must be limited to 90 days, unless the ILEC proves to the Commission that not applying the resellers' wholesale discount to the promotional offering is a reasonable and nondiscriminatory restriction on the ILEC's resale obligation." First Resale Order, pp. 11-12.

21. On February 18, 2005, BellSouth filed a Motion for Reconsideration or, in the Alternative, For Clarification, and for a Stay of the Commission's December 22, 2004 Order.

22. On June 3, 2005, the Commission issued its Order Clarifying Ruling on Promotions and Denying Motions for Reconsideration and Stay ("Second Resale Order"). A copy of the Second Resale Order is attached hereto as Exhibit D. The Commission effectively rewrote section 252(d)(3) of the Act by holding that marketing incentives have the effect of lowering "the actual, 'real' retail rate." Second Resale Order, p. 5. Having so held, the

Commission required that BellSouth determine "the price lowering impact of any such 90-day-plus promotions on the real tariff or retail list price" and pass the benefit of such a reduction on to resellers through a wholesale discount on the "lower actual retail price." Second Resale Order, p. 6. The Commission provided no guidance on how this hypothetical "real retail price" should be calculated, instead stating that it "intentionally left this matter open so that the parties would be free to negotiate." *Id.* If a negotiated solution is not possible, the ILECs and CLPs may bring the matter before the Commission, but if it is too difficult to calculate the "real retail price," the Commission will presume that a marketing incentive "would be unreasonable and discriminatory." Second Retail Order, pp. 6-7.

23. On June 27, 2005, BellSouth filed a Motion for Extension of Time to Appeal the Second Resale Order. On June 28, 2005, the Commission granted this Motion and extended the time for BellSouth to appeal the Second Resale Order to August 2, 2005.

24. On August 2, 2005, BellSouth filed a Complaint against the North Carolina Utilities Commission and the individual Commissioners in the United States District Court for the Western District of North Carolina (Civil Action No. 3:05-CV-345-MU) (hereinafter, the "NCUC Action") seeking, among other things, a declaratory judgment that the provisions of the First and Second Resale Orders concerning BellSouth's resale obligations for marketing incentives violated federal law. A copy of this Complaint is attached hereto as Exhibit E. BellSouth also filed a motion for a temporary restraining order and a preliminary injunction preventing enforcement of portions of the First and Second Resale Orders during the pendency of the action.

25. On August 2, 2005, the Honorable Graham C. Mullen, Chief United States District Court Judge, entered an Order temporarily restraining the Commission and the individual Commissioners from enforcing Conclusion No. 5 of the First Resale Order and the

Commission's Conclusions regarding resale obligations and one-time gift promotions in its Second Resale Order. A copy of this Order is attached hereto as Exhibit F.

26. On August 12, 2005, following a hearing, Judge Mullen entered an Order preliminarily enjoining enforcement of Conclusion No. 5 of the First Resale Order and the Commission's Conclusions in the Second Resale Order regarding resale obligations and one-time gift promotions. A copy of this Preliminary Injunction Order is attached hereto as Exhibit G. In short, the Court preserved the status quo, in which BellSouth was not obligated to provide CLPs with an additional discount based on some value associated with marketing incentives such as gift cards or cash-back coupons.

27. The parties to the NCUC Action have filed cross-motions for summary judgment, and briefing on those motions has not been completed.

IMAGE ACCESS' BREACH OF THE 2002 AND 2006 ICA'S

28. In October 2004, Image Access began withholding payment for amounts billed by BellSouth for telecommunications services sold to Image Access under the resale provisions of the 2002 ICA. Image Access claimed that it was entitled to the value of various cash-back coupon or gift card promotions utilized by BellSouth as marketing incentives. The basis for Image Access' claim was that these marketing incentives were "promotions" as that term was used by the FCC in its First Report and Order, *see* Paragraph 16, *supra*, and that it was entitled to receive credit for those alleged promotions at the discounted wholesale rate, provided that they were not in effect for 90 days or less.

29. Each month since this dispute arose, Image Access has transmitted to BellSouth a list of end users for whom Image Access claims it should receive a credit for various marketing incentives utilized by BellSouth. For example, for every customer in a given month to whom